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Nos. 99-1642, 99-1643, 99-1644

In The

Supreme Court of the United States

IN RE: THEODORE B. GOULD,

Petitioner.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

REPLY BRIEF FOR PETITIONER

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15 pp

TABLE OF CONTENTS

Page

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

REPLY BRIEF FOR THE PETITIONER..... 1

1. The Jurisdictional Issues 1

2. The Conduct of The Government's Attorneys... 6

3. The Liability Of The Bank And Smith For The Damages Caused By Breach Of Trust And Fraud 8

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES

Bull v. United States, 295 U.S. 247 (1935) 8

Curtis Manufacturing Company, Inc. v. Plastic Clip Corp., 888 F.Supp. 1212 (1994)..... 3

General Utilities and Operating Co. v. Helvering, 296 U.S. 200 (1935) 7

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989) 3

Holywell Corporation, et al. v. Smith, 503 U.S. 47 (1992) 1, 2, 3, 4

In re Dahlgren, Int'l, Inc., 147 B.R. 393 (N.D. Tex. 1992)..... 3

In re Hallock, 154 B.R. 297 (Bkrtcy. S.D. Ariz. 1993) 3

In re Hartman Material Handling Systems, Inc., 141 B.R. 802 (Bkrtcy. S.D. N.Y. 1992) 3

In re Holywell Corp., 911 F.2d 1539 (11th Cir. 1990) 2

In re Holywell Corp., 913 F.2d 873 (11th Cir. 1990) 10

In re Lancy, 208 B.R. 481 (Bkrtcy. D. Ariz. 1997)..... 3

In re Williams, 152 B.R. 123 (Bkrtcy. N.D. Tex. 1992) 3

Matter of Lemco Gypsum, Inc., 910 F.2d 784 (11th Cir. 1990) 4

National Muffler Dealers Ass'n v. United States, 448 U.S. 472 (1979) 6

Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982)..... 3, 4, 5

TABLE OF AUTHORITIES – Continued

Page

Smith v. Bank of New York, 161 B.R. 302 (Bkrtcy. S.D. Fla. 1993) 3

United States v. Moore, 95 U.S. 760 (1878) 6

United States v. Nordic Village, Inc., 112 S.Ct. 1011 (1992) 3, 5

Williams v. Austrian, 331 U.S. 642 (1947) 5

STATUTES

11 U.S.C. § 505(a) 2, 3

11 U.S.C. § 541(a) 5

11 U.S.C. § 1104(a) 5

11 U.S.C. § 1123(a)(5)(B) 1, 8

11 U.S.C. § 1141(a) 3

11 U.S.C. § 1142 5

26 U.S.C. § 336 7

26 U.S.C. § 361(c) 7

26 U.S.C. § 6901 9

26 U.S.C. § 7805(a) 6

28 U.S.C. § 157(b)(2) 5

28 U.S.C. § 1254(1) 2

28 U.S.C. § 1334 4

28 U.S.C. § 2201 3

TABLE OF AUTHORITIES – Continued

Page

OTHER MATERIALS

Kinel and Neier, "Post-Confirmation Jurisdiction In the Bankruptcy Courts; Does It Ever End?" *The Business Lawyer*, November 1999, vol. 55, p. 81..... 4

REPLY BRIEF FOR THE PETITIONER

The briefs in opposition[1] filed by the attorney for the respondents Bank of New York[2] ("Bank") and Fred Stanton Smith ("Smith")[3] show the importance of providing guidelines for the lower courts to resolve the principal questions presented in the three petitions for a writ of certiorari filed in these proceedings, which may be summarized as follows:

(1) Do the judgments, orders and opinions of the court of appeals, and the lower courts, conform to this Court's opinion, ***Holywell Corporation, et al. v. Smith,*** 503 U.S. 47, 54 (1992), that a trustee appointed after confirmation, to effect the liquidation of a discharged individual debtor's estate, is "the fiduciary of a trust of an individual"?

(2) Does a bankruptcy court have jurisdiction to enter final judgments, subject to appellate review, concerning the administration under State law of postconfirmation claims against the property of a new separate and distinct trust created in accordance with 11 U.S.C. § 1123(a)(5)(B)?

1. The Jurisdictional Issues

(a) The respondents' argument that "if the bankruptcy court had no subject matter jurisdiction over this adversary proceeding initially (as alleged by Petitioner),

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[1] The Solicitor General has waived his right to file a brief in opposition as a respondent in No. 99-1643.

[2] References herein to the briefs of the respondents in opposition will be cited as "No. 99-___ at ___."

[3] The court of appeals rejected the petitioner's objection on the grounds of conflict of interest to Smith's motion for the Bank's attorney to represent him as trustee of the Miami Center Liquidating Trust.

it would follow that the appellate courts – including this Court – lacked jurisdiction as well," *No. 99-1643* at 14, is a blatant false representation of the facts and the existing laws applicable in these proceedings.

First, this Court had appellate jurisdiction in the prior proceedings under 28 U.S.C. § 1254(1), because the opinion of the court of appeals was an erroneous judgment of law, which held:

> We dismiss, as moot, the allegation that the bankruptcy court lacked authority to confirm the Plan, and the allegation that the Bank of New York acted fraudulently in obtaining approval of the Plan. We accept jurisdiction to decide whether the liquidating trustee breached his duty either under the terms of the Plan or other statutory provisions. We hold, however, that neither the provisions of the Plan nor the statutory provisions obligate the liquidating trustee to file income tax returns or pay taxes.

In re Holywell Corp., 911 F.2d 1539, 1546 (11th Cir. 1990). This Court held that the trustee was required to discharge duties imposed upon fiduciaries under the provisions of the Internal Revenue Code. 503 U.S. at 52.

Second, the trustee's initial adversary complaint for declaratory relief filed on December 27, 1987, did *not* seek the bankruptcy court's determination, under 11 U.S.C. § 505(a), of "(b) the amount of the taxes due." See *Petition No. 99-1643* at 12 ("Upon remand, the Trustee *amended* his adversary complaint . . . to determine the amount and priority of the taxes due the United States.")

Third, the Internal Revenue Service ("IRS") and various courts have followed this Court's ***Holywell*** opinion that 11 U.S.C. § 1141(a) is not binding with respect to postconfirmation claims, 503 U.S. at 58-59, as the controlling authority with respect to the question of whether a bankruptcy court has jurisdiction under 11 U.S.C. § 505(a)

to enter a final judgment, determining the amount of postconfirmation income taxes pursuant to 28 U.S.C. § 2201. See ***In re Hartmann Material Handling Systems, Inc.***, 141 B.R. 802, 810 (Bkrtcy. S.D. N.Y. 1992), quoting ***Holywell***, 503 U.S. at 58 (11 U.S.C. § 105 does not permit a bankruptcy court to determine the amount of postconfirmation tax liabilities); ***In re Hallock***, 154 B.R. 297, 302 (Bkrtcy. S.D. Ariz. 1993), citing ***Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.***, 458 U.S. 50 (1982), ***Granfinanciera, S.A. v. Nordberg***, 492 U.S. 33 (1989), ***United States v. Nordic Village, Inc.***, 112 S.Ct. 1011 (1992), and ***Holywell*** (a bankruptcy court lacks subject matter jurisdiction "under 11 U.S.C. § 505 or another provision of the Bankruptcy Code [unless] it is . . . relate[d] to the bankruptcy estate or to discrete issues concerning whether a particular tax is nondischargeable"); ***Curtis Manufacturing Company, Inc. v. Plastic Clip Corp.***, 888 F.Supp. 1212, 1218 (1994), quoting ***In re Dahlgren, Int'l., Inc.***, 147 B.R. 393, 404 (N.D. Tex. 1992) ("[p]re-confirmation . . . does not encompass a postconfirmation time frame"); ***In re Williams***, 152 B.R. 123, 128 (Bkrtcy. N.D. Tex. 1992) (Liquidating trustee is not a bankruptcy trustee); and also ***In re Lancy***, 208 B.R. 481, 485 (Bkrtcy. D. Ariz. 1997), citing ***Holywell***, held "the [trustee's] duty to pay taxes arose out of events separate and independent of bankruptcy. Taxable income was earned postconfirmation. The trustee had a duty under the Internal Revenue Code to file a return and pay taxes regardless of the bankruptcy, 503 U.S. at 56-59. . . . A bankruptcy court has limited postconfirmation powers. Essentially, the court's continuing jurisdiction is to simply ensure that the plan provisions are met." See ***Smith v. Bank of New York***, 161 B.R. 302, 307 (Bkrtcy. S.D. Fla. 1993) (The plan made no provision for the trustee's payment of postconfirmation income taxes.)

In summary, this Court had jurisdiction in the prior proceedings to reverse the erroneous judgment of the court of appeals that the trustee was not required to file returns and pay income taxes in accordance with the applicable provisions of the Internal Revenue Code. However, in the proceedings remanded for hearings in conformity with this Court's ***Holywell*** opinion, the trustee would have been a defendant and the court of appeals should have vacated its prior opinion and remanded the proceedings to the district court with instructions that the bankruptcy court dismiss the trustee's adversary complaint for want of jurisdiction.

(b) The representation of the respondents' attorney is false that the bankrutpcy court's lack of postconfirmation jurisdiction[4] was not raised in the court of appeals, *No. 99-1642* at 8. The petitioner's initial brief, at 24, argued:

> It is also uncontroverted that the bankruptcy court lacked subject matter jurisdiction to hear the claims in this adversary proceeding, 4 *supra*, quoting ***Northern Pipeline Construction Co. v. Marathon Pipe Line Co.***, 458 U.S. 50, 102 S.Ct. 2850 (1982), and in ***Matter of Lemco Gypsum, Inc.***, 910 F.2d 784 (11th Cir. 1990), this Court reversed a district court's affirmance of a civil contempt fine imposed by a bankruptcy court on the grounds that a bankruptcy court could not exercise jurisdiction over a particular proceeding if 28 U.S.C. § 1334 did not provide jurisdiction to the district court. 910 F.2d at 789.
>
> This proceeding is not a case under title 11, and does not arise in, nor is it related to, a case

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[4] See *Post-Confirmation Jurisdiction In the Bankruptcy Courts: Does It Ever End?*, Kinel and Neier, ***The Business Lawyer***, November 1999, vol. 55, at 81.

> under title 11, because the claims concern post-confirmation events. See 910 F.2d at 788; 11 U.S.C. § 1142 (a bankruptcy court's postconfirmation jurisdiction is limited to the issuance of orders to implement a confirmed plan); also 112 S.Ct. at 1028 (a creditor under title 11 is a person with a preconfirmation claim).

The court of appeals held "this adversary proceeding involves a core proceeding because it involves a matter regarding allowance and estimation of claims involving the trust. See 28 U.S.C. § 157(b)(2). Gould's claim that the bankruptcy court does not have jurisdiction is without merit." App. 13. Thus, the question is whether the opinion of the court of appeals is correct that the bankruptcy court had statutory authority to retain jurisdiction under the provisions of the Bank's plan to enter binding orders concerning the trustee's conduct and the trust's property on the grounds that the bankruptcy court appointed Smith, as trustee of the Miami Center Liquidating Trust, *No. 99-1642* at 9, notwithstanding that (1) the Bank retained sole authority to dismiss the trustee, (2) Smith was not a bankruptcy trustee, or (3) a "trustee in a case under title 11," appointed under 11 U.S.C. § 1104(a), and (4) the bankruptcy court's administration of the estate created under § 541(a) ended as an effect of confirmation, see 502 U.S. at 55 ("The plan . . . 'declared and established' the new Miami Center Liquidating Trust . . . it created a separate and distinct trust").

Marathon, 102 S.Ct. at 2872, n. 26, held, citing ***Williams v. Austrian***, 331 U.S. 642, 658 (1947), that the district court has jurisdiction, and the concurring opinion concluded that "Marathon may object to proceeding further with this lawsuit on the grounds that if it is to be resolved by an agency of the United States, it may be resolved only by an agency which exercises 'the judicial

power of the United States' described by Art. III of the Constitution," 102 S.Ct. at 2881.

2. The Conduct of The Government's Attorneys.

In the prior proceedings before this Court, the Solicitor General argued, citing ***National Muffler Dealers Ass'n v. United States***, 448 U.S. 472, 477 (1979), that

> Congress has delegated to the . . . Commissioner [of Internal Revenue], not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a). ***United States v. Correll***, 389 U.S. at 307 . . . that delegation helps ensure that in "this area of limitless factual variations," ***Ibid***, like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," ***United States v. Moore***, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect.

The Solicitor General also argued that "Congress has ensured that the duty to report and pay taxes will follow the assets from which income is realized and from which the tax payment is made," ***Petition Of United States For A Writ Of Certiorari***, March 1991 at 10. This Court agreed and held that "the trustee must pay the tax on the income attributable to the corporate debtors' property," 503 U.S. at 52.

The IRS ***Holywell*** Report at 39, issued on July 14, 1992, concluded from the evidence that the Bank's plan was a scheme to avoid the payment of income taxes, which included, *inter alia*,

> (c) One of the provisions of the Plan was the elimination of the claims of Holywell Telecommunications Company and Holywell Leasing Company. As of October 10, 1985, the total amount of rents due thse two nondebtor subsidiaries of Holywell from Miami Center Limited

> Partnership was $3,315,672 plus interest. This was money that could have been used to help satisfy Holywell's tax liability.
>
> (d) The inclusion of the proceeds from the sale of the Washington Properties that included approximately $13,000,000 that belonged to Twin Development Corporation in the "Trust Property." Twin Development was a nondebtor subsidiary of Holywell and was severally liable for the taxes of the consolidated group. . . .
>
> (f) The conveyance of the property of Holywell Telecommunications Company and Holywell Leasing Company to the designee of the Bank of New York without consideration. This further deprived the consolidated group of assets that could have been used to satisfy its tax liability. . . .

The IRS also concluded that "Section 361(c) of the Code provides that no [gain or] loss shall be recognized by a corporation a party to a reorganization on the distribution to its shareholders of property in pursuance of the plan of reorganization," IRS ***Holywell*** Report at 36.[5] Nonetheless, the Government's attorneys negotiated a settlement of income taxes illegally asserted against Holywell, see Petition *No. 99-1643* at 29, and relieved

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[5] In accordance with 26 U.S.C. § 336, prior to August 1, 1986, no gain or loss was recognized to a liquidating corporation on the distribution of property in complete liquidation, and, thus, the dividend distribution of Holywell's property and cash to the trustee of the Miami Center Liquidating Trust did not cause Holywell to incur a tax liability upon the transfer of its property to the trustee. In addition, under 26 U.S.C. § 361(c), prior to August 1, 1986, no gain or loss was recognized by the corporation, if as a party to a liquidating plan of reorganization, it dividended its property and cash to its shareholder pursuant to such plan. See ***General Utilities and Operating Co. v. Helvering***, 296 U.S. 200, 204 (1935) ("the declaration and payment of the dividend resulted in no taxable income.").

Smith of penalties for negligence and personal liability upon his use of the Miami Center Liquidating Trust's funds to pay $10,000,000 for which the IRS asserted Holywell was liable after Holywell had ceased business, had no assets, and no income. See ***Bull v. United States***, 295 U.S. 247, 261 (1935) ("The United States . . . cannot, as against the claim of an innocent party, hold his money. . . . [T]he unjust retention is immoral and amounts in law to a fraud on a taxpayer's rights.").

3. The Liability Of The Bank And Smith For The Damages Caused By Breach Of Trust And Fraud

Although the respondents have conceded that "the federal tax implications of the [Bank's] plan," *No. 99-1643* at 5, was the primary reason for the bankruptcy court's failure to issue a final decree closing the cases in accordance with Bankruptcy Rule 3022, their argument that the trustee's duties under the plain language of the Internal Revenue Code was a "novel question" does not resolve the question of whether a trustee appointed as the fiduciary of a trust created under 11 U.S.C. § 1123(a)(5)(B) must (a) act with undivided loyalty to the trust's beneficiary, and not be guided by the interests of a third person; (b) use reasonable care and skill to preserve the trust property; (c) defend actions which may result in a loss to the trust estate; and (d) not engage in conduct which he knows, or should have known, is illegal, and would be injurious to the trust's beneficiary.

In this case, law and equity requires that the trustee wear a *badge of fraud* for paying money to the Bank after the Bank had indemnified him for his actions under the plan's provisions, and for the failure to seek the bankruptcy court's instructions concerning repayment of the "super-priority" loans, and an IRS ruling concerning the normal administrative procedures for the determination

of the amount of the tax liabilities, see 26 U.S.C. § 6901,[6] prior to the commencement of distribution under the provisions of the Bank's plan.

The final argument of the respondents for the trustee's failure to repay the "super-priority" loans from the proceeds of MCLP's estate based on the erroneous "owned and owed" theory, and that "[e]ven if the loans were repaid from one estate to another . . . then the administrative expenses and creditors would still be repaid before the debtor," *No. 99-1644* at 13, n. 10, is a

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[6] 26 U.S.C. § 6901, ***Transferred assets***, provides, in part:

> (a) **Method of collection.** The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:
>
> (1) **Income, estate, and gift taxes.**
>
> A. Transferees. The liability, at law or in equity, of a transferee of property –
>
> (i) of a taxpayer in the case of a tax imposed by subtitle A (relating to income taxes),
>
> (ii) of a decedent in the case of a tax imposed by chapter 11 (relating to estate taxes), or
>
> (iii) of a donor in the case of a tax imposed by chapter 12 (relating to gift taxes),
>
> in respect of the tax imposed by subtitle A or B.
>
> B. Fiduciaries. The liability of a fiduciary under section 3713(b) of title 31, United States Code in respect of the payment of any tax described in subparagraph (A) from the estate of the taxpayer . . . .

blatant assertion that the trustee's commingled accounting of postconfirmation claims against the liquidating trust with the preconfirmation claims of creditors under title 11 was not actual fraud and that the Bank is not liable as the plan's proponent for the damage to the Miami Center Liquidating Trust and its beneficiary, caused by the trustee's payment of accrued interest, attorneys' fees, fiduciary fees, and accounting expenses, attributable to the plan's wrongful subordination of the valid claims of insiders, see ***In re Holywell Corp.***, 913 F.2d 873, 880 (11th Cir. 1990), and the Bank's failure to disclose its intent that the trustee appointed under the plan's provisions would be relieved of discharging fiduciary duties imposed by law. See 161 B.R. at 307.

CONCLUSION

For the foregoing reasons, and the reasons stated in the petitions, each of the petitions for a writ of certiorari should be granted and consolidated for briefing and oral argument.

Respectfully submitted,

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